Emphasis On Customer Value

Duke Marketing Efforts Benefit Shareholder, Customer Alike

Duke Power responded to an increasingly competitive energy marketplace in 1989 with programs designed to emphasize the advantages of electricity and encourage increased use of off-peak power.

These ongoing efforts are part of Duke Power's plan to enhance revenues while limiting the pressure on peak demand requirements as Duke Power heads into the '90s.

While revenues in 1989 increased marginally — from $3.63 billion to $3.64 billion — earnings per share of common stock increased from $4.91 to $5.13. An increase in kilowatt-hour sales billed to commercial and industrial customers, coupled with lower plant maintenance expenses, were the principal reasons for the increase in earnings.

Annual earnings were affected by a charge of 11 cents a share made in the first quarter of 1989. In April, Duke Power lowered its rates and made provisions to refund $24 million in July to customers under a remand order from the North Carolina Utilities Commission. Responding to a directive from the state Supreme Court, the Commission reduced the Company's allowed return on equity to 13.2 percent from 13.4 percent, retroactive to 1986. Going forward, this reduces the Company's annual revenue by approximately $9 million.

The Company's earnings trend was affected by three factors that occurred in 1988. They include a $1.01 per share increase resulting from the cumulative effect of an accounting change effective January 1988, a one-time charge of 46 cents per share in December 1988 resulting from a D.C. Court of Appeals ruling, and a reduction in earnings of 15 cents a share for employee benefits following the Company's work activity review completed in late 1988.

Damage from Hurricane Hugo cost the Company approximately $64 million. The capital portion of these costs, about $44 million, will be capitalized and depreciated over approximately 30 years. The Company received from the appropriate regulatory commissions approval to amortize for accounting purposes the remaining $20 million over a five-year period. Another $3.5 million in maintenance costs from tornadoes that struck the Piedmont in May will be amortized over a five-year period.

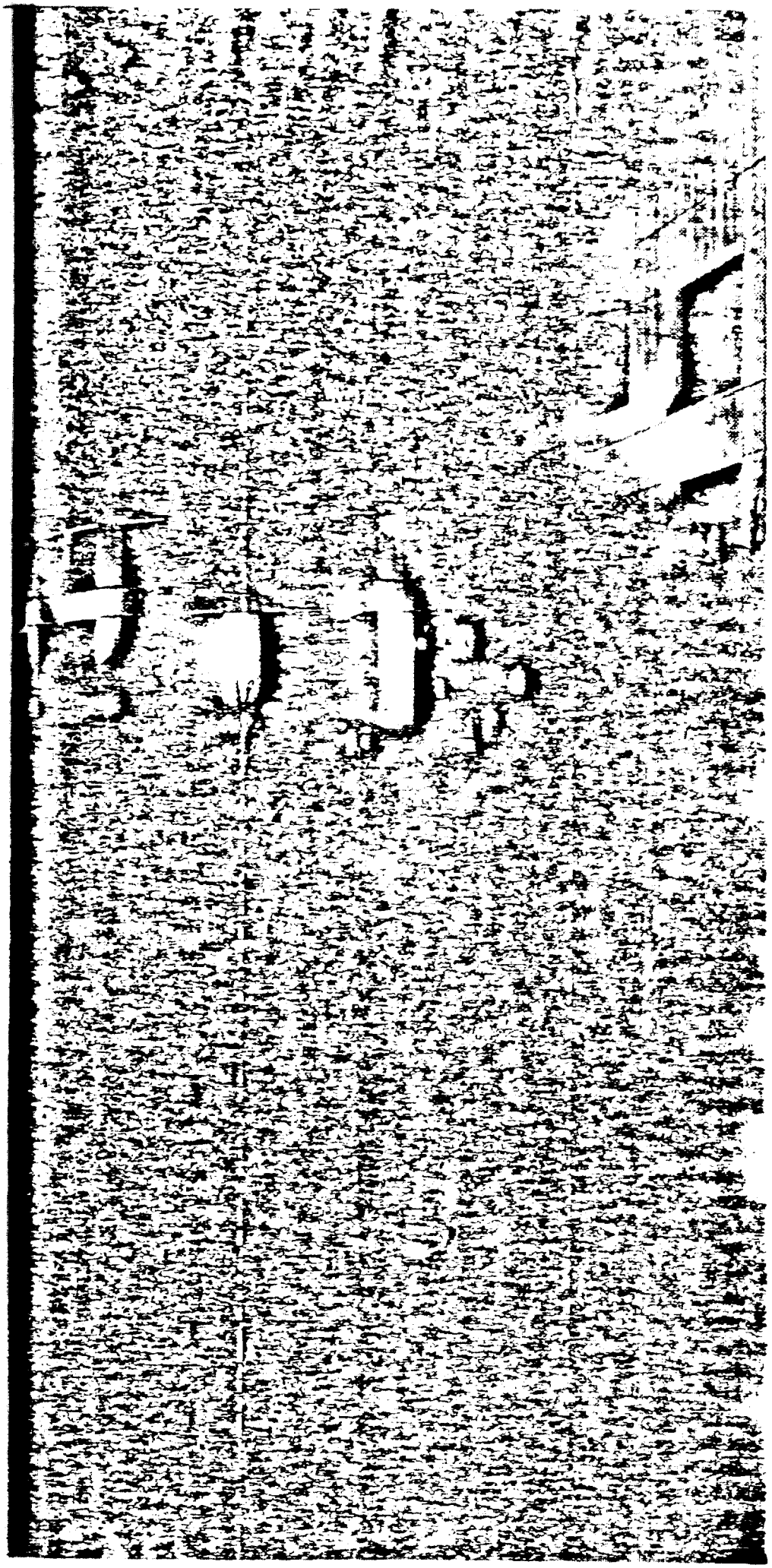
Duke Power dissolved its nuclear fuel trusts, which totalled $86 million, in 1989 and created a $130 million commercial paper financing program backed by long-term financing agreements. This program provided $44 million in new funds for general utility purposes.

The Company issued $200 million of new bonds in February 1990. The new bonds carry a 9¼ percent interest rate and mature in 2020. A portion of the proceeds will be used in March to refund the $62,916 million of Duke's 12⅜ percent bonds due 2015. Replacing the old bonds will result in approximately $26 million in savings for the Company's customers over the next 25 years. The Company intends to issue additional long-term debt in 1990 to fund general utility requirements.

Duke Power also plans in 1990 to implement a $250 million secured medium-term note program. Besides offering greater flexibility to react to debt market conditions, medium-term notes serve as a complement to Duke's core financing program of long-term bonds.

Duke's Board of Directors raised shareholders' quarterly dividend to 78 cents, effective in the third quarter of 1989. This increased the indicated annual dividend to $3.12 and marked the Company's 14th consecutive dividend increase. The ac-

Dramatic outdoor lighting and comfortable heating and cooling with a high-efficiency heat pump make offices like Charlotte's Rotunda Building prime business addresses. Duke Power's Central Division offices are located here.



tion is consistent with the Company's goal to provide steady dividend growth and to pay out approximately 60 to 65 percent of earnings for common stock.

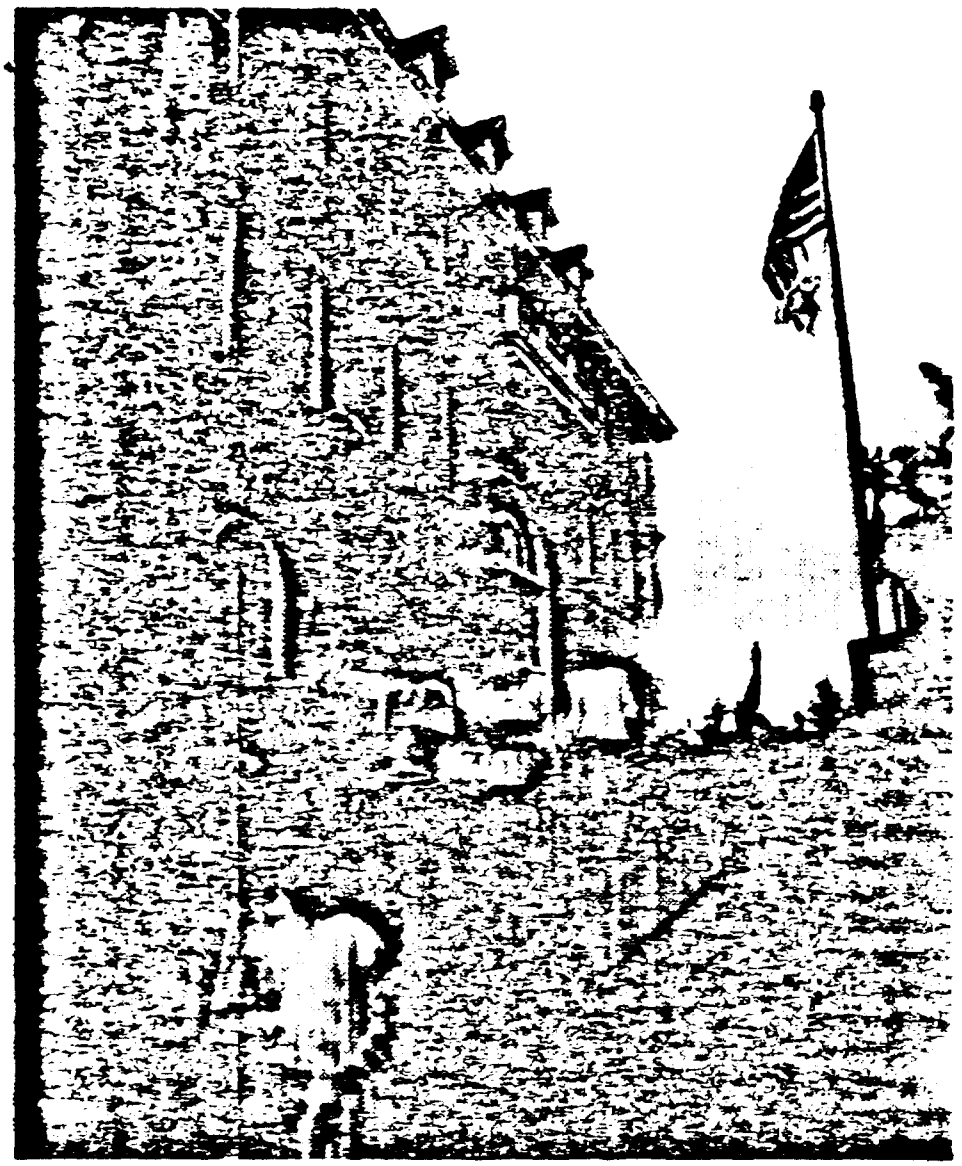
Peak demand in 1989 reached 13,611,000 kilowatts on August 23, a relatively mild summer day. Had temperatures been normal the estimated peak would have exceeded 14 million kilowatts. This compares with Duke's all-time high of 13,618,000 kilowatts set on August 18, 1988.

Duke's marketing efforts in 1989 continued to center on programs that encourage off-peak power consumption and reduction in the growth rate of peak demand. The Company created the Comfort Guarantee in 1989 to promote the benefits of the MAX — the all-electric Maximum Value Home. The optional guarantee assures homeowners who install The Comfort Machine (a high-efficiency heat pump) that they will be comfortable, or Duke Power will install a comparable heating system of the homeowner's choice.

1989 Sales – KWH	
Residential	+ 0.9%
General service	+ 4.2%
Textile	+ 2.8%
Non-textile industrial	+ 3.4%
Total industrial	+ 3.1%
All other	— 8.0%
Total	+ 1.0%

Both the MAX and the Comfort Guarantee programs promote off-peak electricity sales and ensure lower peak demand. The MAX home enables the Company to increase sales for winter home heating without adding to the demand for summer cooling power as a result of increased insulation, efficient building practices and high-efficiency heating and cooling equipment. Marketing off-peak energy creates more sales over which to spread costs and maintains the high value delivered to customers.

To help customers get the most from its marketing programs, Duke Power created its Power Marketing Team from the employees who have served as industrial or commercial marketing representatives. These energy professionals draw on expertise throughout the Company to help Duke customers maintain better control over their energy use with a variety of free programs and services. Companies with



Duke Power's new Greenville office represents the Company's commitment to the growth of the Upstate. The new facility is Duke's flagship office in South Carolina.

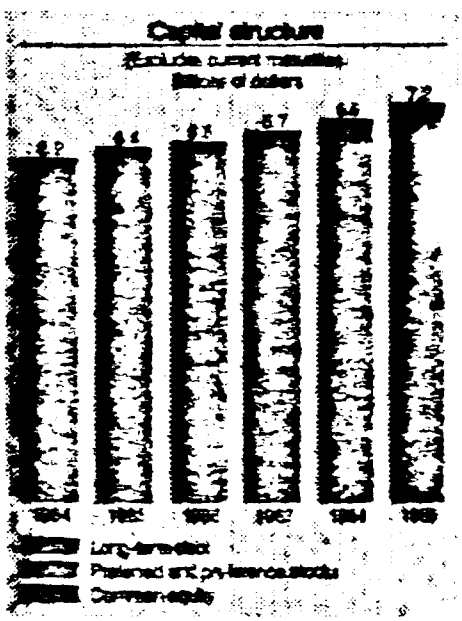
specialized needs can call their Duke Power representative for help and information.

Duke is also responding to industrial customers' needs with enhanced interruptible service and improved standby generator rates as part of the Load Management program. The Company has received letters of intent from many companies desiring to participate in one of these two programs.

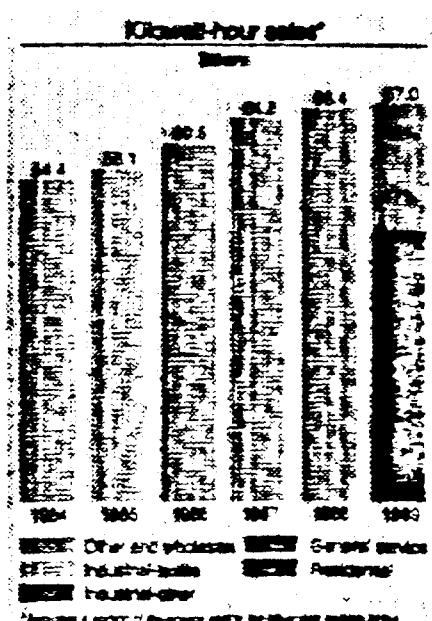
Many companies, including textile manufacturers, are finding interruptible service enhancements attractive because Duke Power can now submeter a plant to temporarily interrupt service affecting a single process instead of an entire plant. Companies with standby generators appreciate this rate option because it not only lowers their energy costs, it also helps them meet periodic equipment testing requirements.

One of Duke Power's strongest selling points continues to be its overall rate stability. The Company has not had a general rate increase since 1986 and anticipates no general rate activity until Bad Creek Hydroelectric Station comes online in the early 1990s. In fact, general rates have decreased three times since 1986 following changes in federal tax law and adjustment of the allowed return in North Carolina.

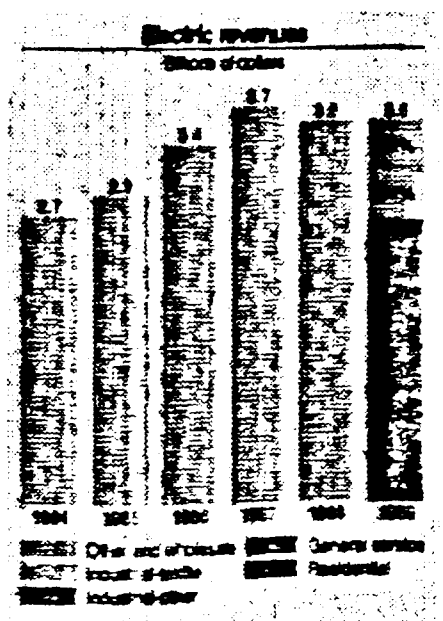
The Company's competitive rates, innovative programs and its willingness to work with customers to meet their particular needs are evidence that Duke is a company that delivers high value to customers. •



Duke Power's long-term debt will increase as the Company moves into its 1990 financing program.



Kilowatt-hour sales increased slightly in 1989.



Total electric revenues remained stable in 1989.

Anticipating Tomorrow

Duke's Efficient Generating System Delivers Value Now and In the Future

Customers benefited from Duke Power's efficient mix of nuclear, fossil and hydroelectric generating plants in 1989.

Baseload demand was met primarily by the Oconee, McGuire and Catawba nuclear generating stations. The seven nuclear units operated by Duke Power ran at an average 77 percent capacity in 1989, providing approximately 63 percent of the electricity used by Duke Power customers.

The plants' generating capacity was well ahead of the national average of 65 percent, and equal to the 77 percent capacity factor recorded in 1988. The nuclear plants continue to live up to Duke Power's tradition of high thermal-operating efficiency. Information from the Nuclear Regulatory Commission (NRC) shows that the stations were the first, second, and sixth most efficient multi-unit nuclear plants in the country in 1988, the latest year for which information is available.

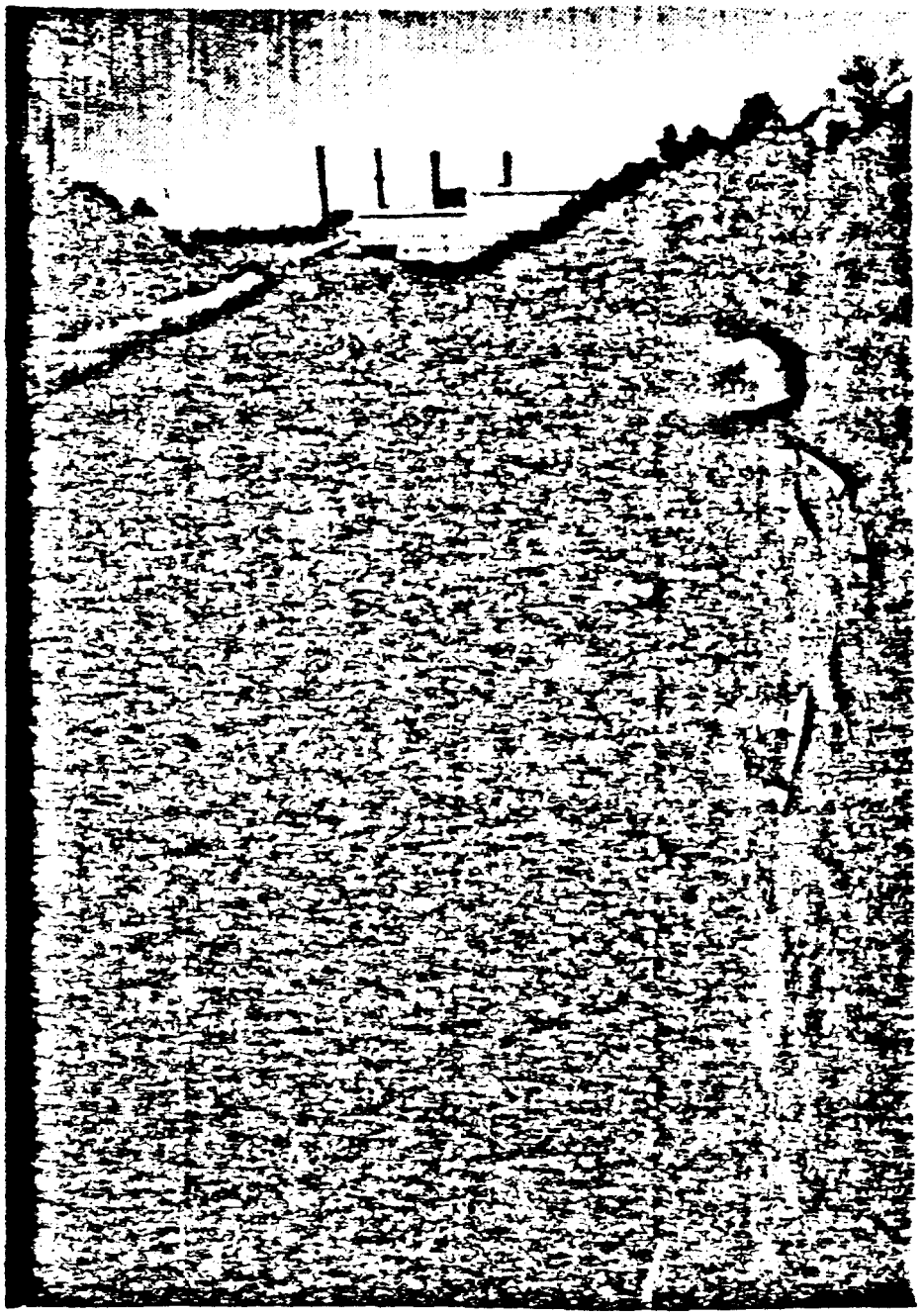
The reactor operator training programs at Duke's McGuire Nuclear Station were re-accredited by the National Academy for Nuclear Training, an independent industry organization devoted to improving nuclear plant safety and the quality of training. The programs at McGuire were first accredited in 1985. Operator programs at Duke's Oconee and Catawba nuclear stations are also accredited. Duke Power was the first utility to achieve Academy accreditation of all its operator programs.

Putting a lid on demand . . .

Amount peak demand was reduced through energy management programs:

1989	
Summer	358,738 kilowatts
Winter	382,408 kilowatts
Since 1975	
Summer	3.5 million kilowatts
Winter	4.3 million kilowatts

In March, a leak in a steam generator tube at McGuire Nuclear Station's Unit 1 caused an alert at the station. The unit was brought off-line without incident and the leak was isolated. While the unit was out of service, the entire tube system was inspected to ensure its integrity. The unit was restored to service in May. This event did not affect the simultaneous operation of McGuire Unit 2.



Duke Power operates the nation's most efficient coal-fired generating plants. That efficiency saved Duke customers $10.1 million in fuel costs in 1988.

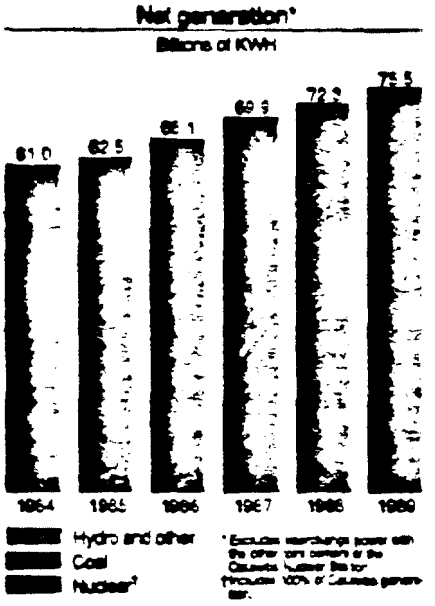
In recognition of his instrumental role in creating the World Association of Nuclear Operators (WANO), Company Chairman and President Bill Lee was elected president of this international body at its organizational meeting in Moscow on May 16. WANO represents owner/operators of all of the more than 400 operating commercial nuclear reactors in the world. Duke's involvement is consistent with the Company's goal of increasing nuclear plant safety and reliability.

Through an electronic information and

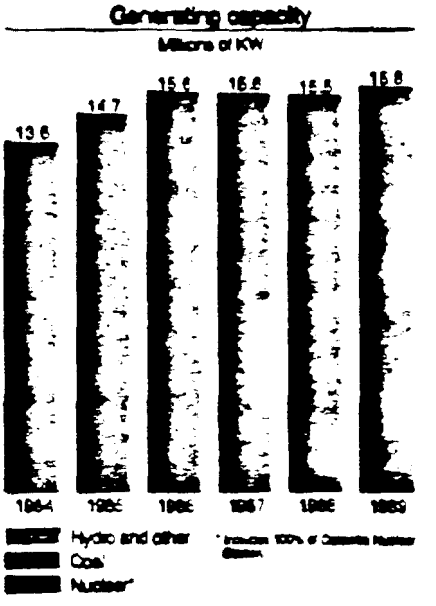
communication network and through exchange visits that ultimately will involve every nuclear station around the globe, WANO is improving safety and performance for all nuclear reactors.

A benefit of Duke Power's nuclear program is a fuel cost structure that is less sensitive to fuel price fluctuations. Fuel constitutes a much smaller proportion of the cost of electricity generated at a nuclear plant than electricity generated at a coal plant.

One component in the cost of nuclear fuel is the process of enriching uranium, a service currently provided in the United States only by the federal government. In an effort to provide an alternative domestic source for such services, Duke Power and four other companies created Louisiana Energy Services (LES) in June. LES



Duke's coal-fired plants provided a larger proportion of the Company's net generation in 1989



Duke Power's baseload demands are still met largely by nuclear plants.

plans to own and operate the nation's first privately owned uranium enrichment facility.

Scheduled for completion in 1996, the plant is expected to supply approximately 15 percent of the U.S. nuclear industry's uranium enrichment requirements.

Duke Power's nuclear plants supply the largest portion of the Company's power needs. But as customer demand has grown in the past several years, Duke's efficient system of eight coal-fired plants has increased output to meet that demand. *Electric Light & Power* magazine has rated Duke's system of coal-fired plants as the most efficient in the nation for 15 consecutive years, including 1988 — the latest year for which statistics are available. Four of Duke's units ranked in the top 10 most efficient plants. If Duke's fossil system had been only as efficient as the second-ranked utility, Duke customers would have paid $10.1 million more in fuel costs.

Coal-fired plants provided 35 percent of the power generated on the Company's system in 1989. With additional savings through the use of nuclear and hydro power, Duke Power's current cost per kilowatt-hour, coupled with prospects of relatively stable rates in the future, continues to be an attractive incentive for companies seeking to locate their business in Duke's service area.

Duke Power has long used low-sulfur coal at its plants to keep emissions from its coal plants to a minimum and to combat the problem of acid rain. Nonetheless, the Company continues its efforts to develop clean-coal technologies; its participation in projects such as the Atmospheric Fluidized Bed Combustion plant in Paducah, Kentucky, ensures that the Company remains at the forefront of development of this important technology.

As part of its effort to continue to provide low-cost power to customers, Duke Power announced in October that it selected a site for a combustion turbine facility. Up to 16 turbines can be installed as they are needed at the Lincoln Combustion Turbine Station, a 700-acre site in Lincoln County, N.C.

The turbines will run on either oil or natural gas during peak periods, giving the Company the option to choose the most economical fuel. Combustion turbine facilities can be built relatively quickly, and turbines, once installed, can be brought on- and off-line quickly. The first turbine is scheduled to begin generating electricity in 1994.

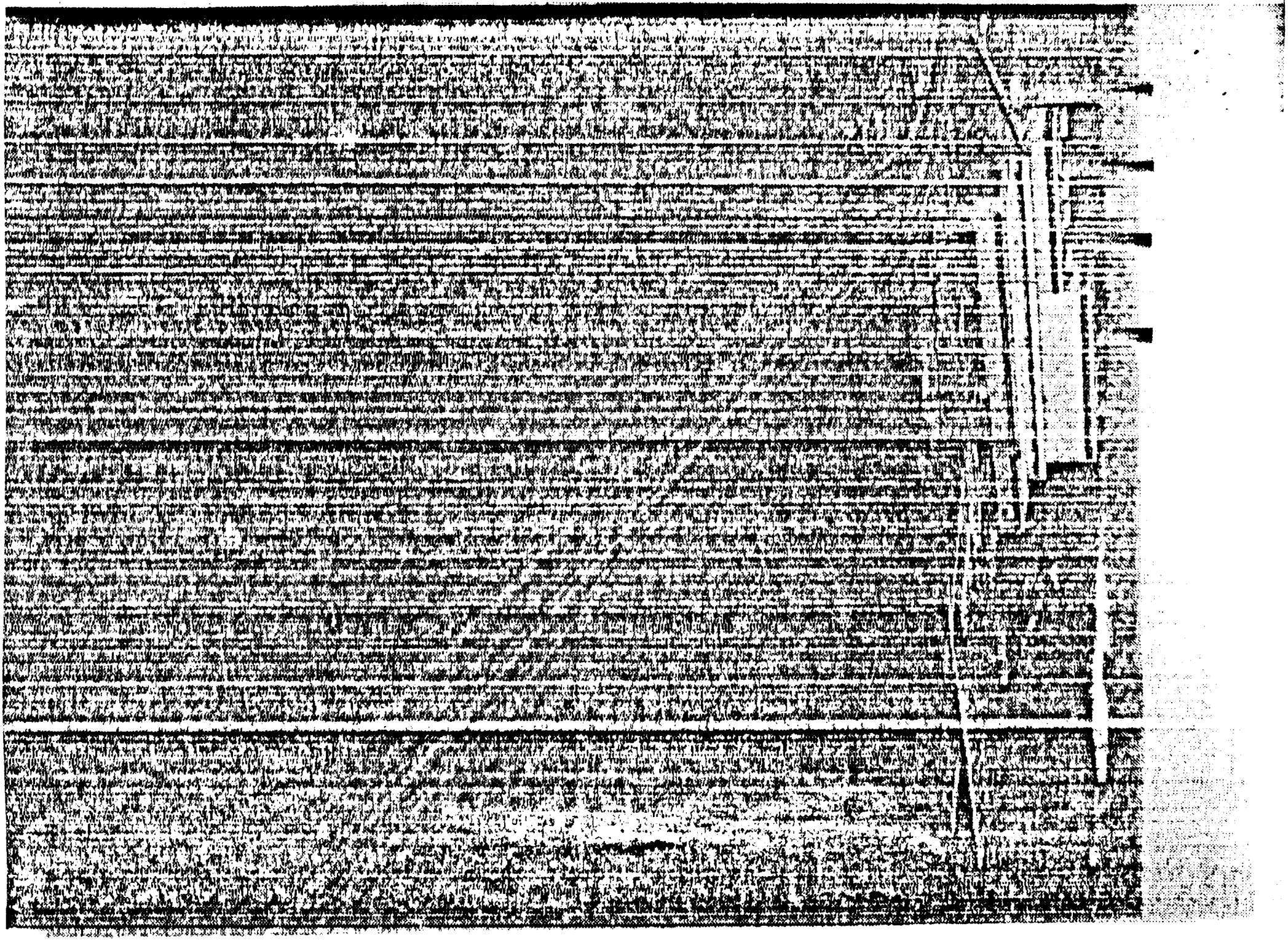
Combustion turbines are part of Duke Power's plan to meet future power needs under the Company's "least cost" plan, a flexible program designed to provide for future needs in the most efficient way possible. Numerous options are being explored to meet power needs in the 1990s and beyond. These options include aggressive load-control and efficiency programs for customers, plus combustion turbines, bulk power purchases, and contracts with independent power producers.

The Company's Bad Creek Hydroelectric Station in northwestern South Carolina is now about 63 percent complete. Completion of units 1 and 2 of this four-unit, 1,065,000-kilowatt station is scheduled for 1992. Units 3 and 4 are expected to be completed by 1993. At the end of 1989, however, construction was running ahead of schedule.

Bad Creek is a pumped storage station that will provide hydroelectric power during peak periods. During peak demand, a pumped-storage station uses water from an upper supply reservoir to turn the turbines that generate power. The water is retained in a lower collection reservoir, then pumped back to the upper reservoir during periods of low energy demand to be ready for the next peak period. Bad Creek will use Lake Jocassee as a collection reservoir and a new small reservoir for upper-level storage.

Bad Creek will be the Company's second pumped-storage facility. The Jocassee Hydroelectric Station, just below Bad Creek, is a 610,000-kilowatt generating station that began operation in 1973. Both Bad Creek and Jocassee, along with the Oconee Nuclear Station and Keowee Hydroelectric Station, are part of the Keowee-Toxaway Energy Park, a concentration of 4,353,000-kilowatts of generating capacity on the upper Savannah River basin. ▼

If Duke Power's coal-fired plants weren't so efficient, they would have used another 2,250 carloads of coal in 1988



Serving More Than Power Needs Through Citizenship & Service

Duke Power's commitment to service means more than providing safe, reliable and economical electric service. The Company's employees devote countless hours to bettering the communities in which they live and work.

Some 2,100 employees participated in the Company's Power in Education program in the 1988-89 school year, donating their personal time to work as volunteer tutors in reading, math, science and many other fields of study. Still others are involved in organizations like the Boy Scouts, Girl Scouts and the United Way. Duke Power and its employees in 1989 pledged more than $2.5 million to the United Way.

Duke Power's Scholastic Excellence Awards program provides six four-year college scholarships and 14 honorary stipends each year to high school seniors within the service area who show exceptional scholastic ability and leadership potential. Another scholarship program, the Duke Power Minority Scholarship, provides scholarships and honorary stipends to minority students seeking degrees in engineering, science, math, computer science, accounting, economics or finance.

President George Bush recognized the Company's support of education in late 1989 by choosing Duke Power as his 29th "Point of Light." The award honors Duke's commitment to volunteerism and education through the Power in Education program.

Duke Power's Community Challenge Heating Fund and Share the Warmth program raised more than $2.1 million during the winter of 1988-89. Share the Warmth matches contributions from customers, employees and shareholders and distributes funds to people needing help with their heating bills regardless of their source of heat.

The Community Challenge Heating Fund matches $1 for each $3 raised by service organizations. Duke Power contributed $325,000 to this fund.

The Metrolina Association for the Blind in North Carolina awarded its 1989 Spivey Award to Duke Power for its contributions to the visually impaired. The award recognized the Company's Energy Information in Braille program, which provides billing information and energy saving tips in Braille to visually impaired customers.

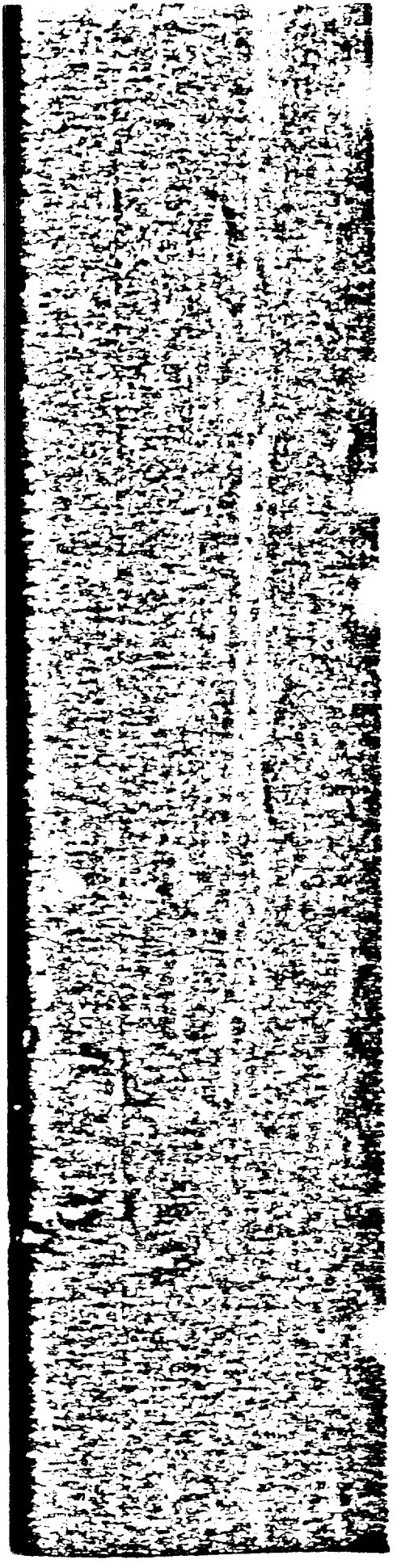
Duke Power has been preparing special Braille bills and inserts for customers since 1986. It currently provides the special format to about 100 customers.

Duke Power also received in 1989 the Honeywell Gold Nugget National Energy Conservation Award, honoring the Company's energy-management programs, which include incentives for higher levels of insulation, efficient lighting, electronic energy controls and thermal energy storage techniques.

In April, the Company was honored with a North Carolina Governor's Award for Excellence for Significant Achievement in Waste Management, recognizing Duke Power's efforts to minimize, recycle and recover solid and hazardous waste material during 1988. These efforts resulted in a savings of $1.4 million through lower waste disposal costs and finding additional uses for waste material. The Company generated another $3.6 million from selling waste material for recycling.

Duke Power employees met seven of their 10 performance Employee Incentive Goals, saving customers millions and producing additional Company contributions to the Stock Purchase-Savings Program for Employees. Goals were met or surpassed in the areas of: customer service — distribution; customer service — transmission; affirmative action; energy management; power plant design, build and test; quality of nuclear operations; and expenditure control.

In the nine years that the goals program has been in force, employees have met 73 of 96 goals for a 76 percent success rate. Additional challenging goals have been set for 1990.



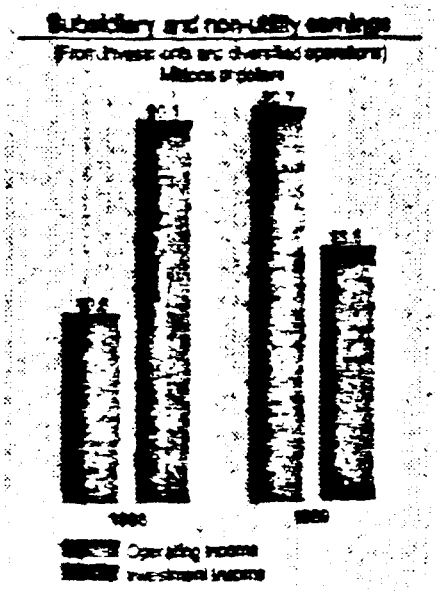
Duke Power is a major contributor to standing on the

Duke's Subsidiaries and Non-Utility Businesses Continue To Grow

As new market opportunities present themselves, Duke Power's subsidiaries and affiliates have accentuated their efforts to provide greater non-utility earnings for the Company.

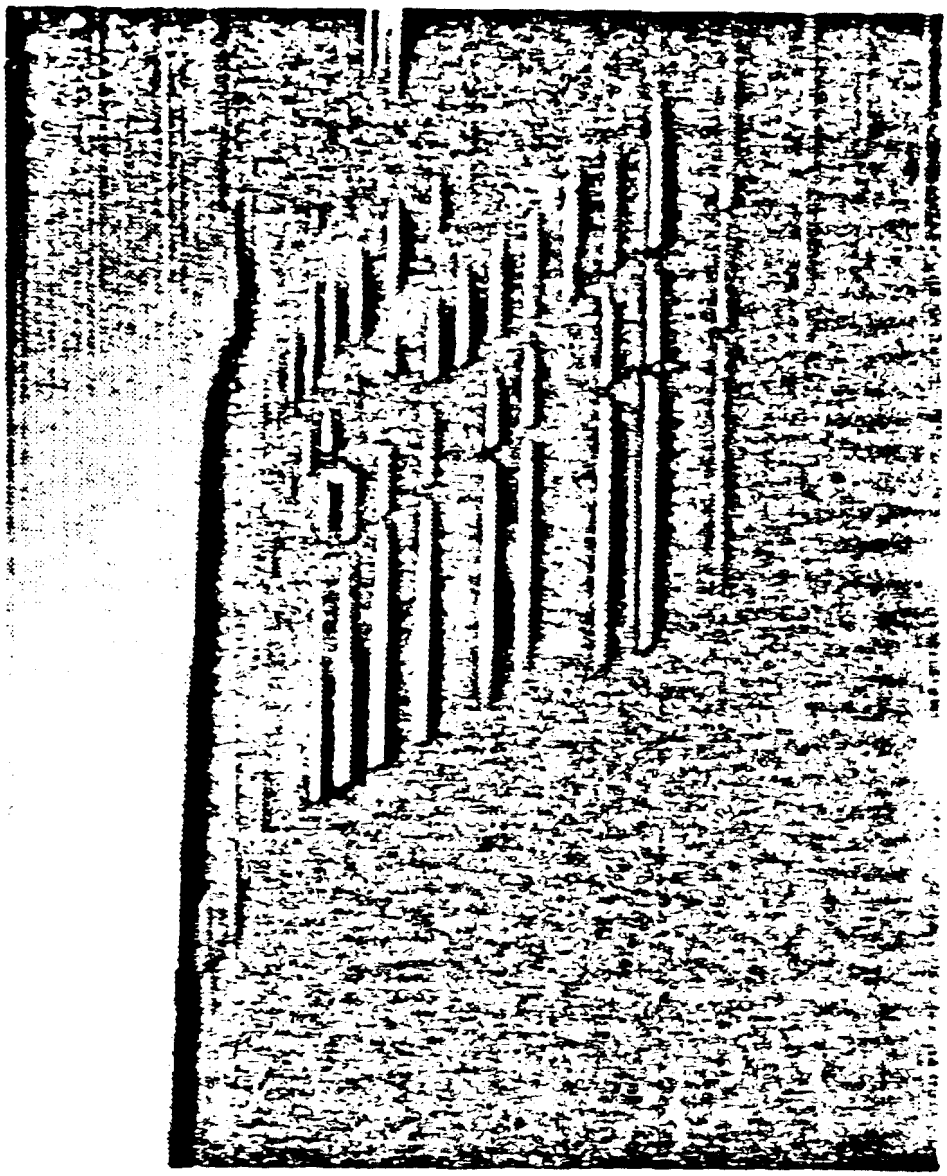
This continued in 1989 with several contracts and agreements that capitalize on the particular services each subsidiary or affiliate is able to offer.

Duke Energy Corp. and TEVCO Power Company are co-developers of two projects to build cogeneration plants totaling 248,000 kilowatts to provide energy to Virginia Power. The steam produced by the plants will be used for industrial processes at plants in Virginia owned by Bur-



Subsidiary and non-utility income contributed 7 percent of earnings for common stock in 1989

orth Carolina Performing Arts Center and t Doug Brook Theater where these artis the Center and others like them will perform for



Crescent Resources Inc., is becoming a major player in commercial real estate. One Coliseum Centre, a 150,000-square-foot Class A office building in Charlotte is scheduled to open in 1990.

Capitalizing

With an eye to the opportunities inherent in growing electricity demand over the next five years, Duke Power and Fluor Corporation of Irvine, Calif., joined forces to create Duke/Fluor Daniel. This 50-50 partnership will offer a new, one-stop source of design, engineering, construction and operation services for new coal-fired power plants as well as repowering, upgrading or modifying existing coal-fired plants. It capitalizes on Duke's design and engineering expertise and Fluor's engineering and construction capabilities.

The partnership will be headquartered in Charlotte, with operating centers in Charlotte and Chicago.

In other non-utility businesses, Duke's Merchandising Operations area added consumer electronics to its product line in 1988, and the additional products helped propel sales growth in 1989. Sales from the merchandising area increased 24 percent in 1989 over 1988.

During 1989, the Company revised its subsidiary structure by contributing the stock of its non-utility subsidiaries to Church Street Capital Corp. Church Street Capital is a subsidiary of Duke Power whose purpose is to provide central management of pooled funds for future needs of non-utility subsidiaries and affiliates such as Duke Energy Corp., Crescent Resources and Duke Engineering & Services, including its interest in Duke/Fluor Daniel.

Duke Power's utility subsidiary, Nantahala Power and Light Company, was acquired in 1988. In 1989, Duke Power began building a transmission line linking the two systems. Construction of the E.B. Shuler Transmission Line, named after Bruce Shuler, former Duke Power vice president, transmission, began in August. Stretching for 26 miles, the line is specially designed to have minimal impact on the area's mountain landscape in Panthertown Valley, while still supplying a reliable, economical source of electricity to Nantahala's 47,000 customers. Nantahala will buy its supplemental power from Duke Power once the line is completed.

Duke purchased the 7,100-acre tract in the Panthertown Valley in 1988 in order

lington Industries. Duke Energy is a Duke affiliate formed in 1988 to develop generating plants outside the Duke Power service area, while TEVCO is an affiliate of Transco Energy Company of Houston, Texas.

Another Duke affiliate, Duke/Fluor Daniel, will design the cogeneration plants, manage the construction, and operate the completed stations.

Duke Engineering & Services (DE&S) won a three-year contract to provide consulting services to the U.S. Department of Energy for that agency's New Production Reactor project. This was one of 115 projects for 70 clients on which DE&S provided engineering and technical services in 1989.

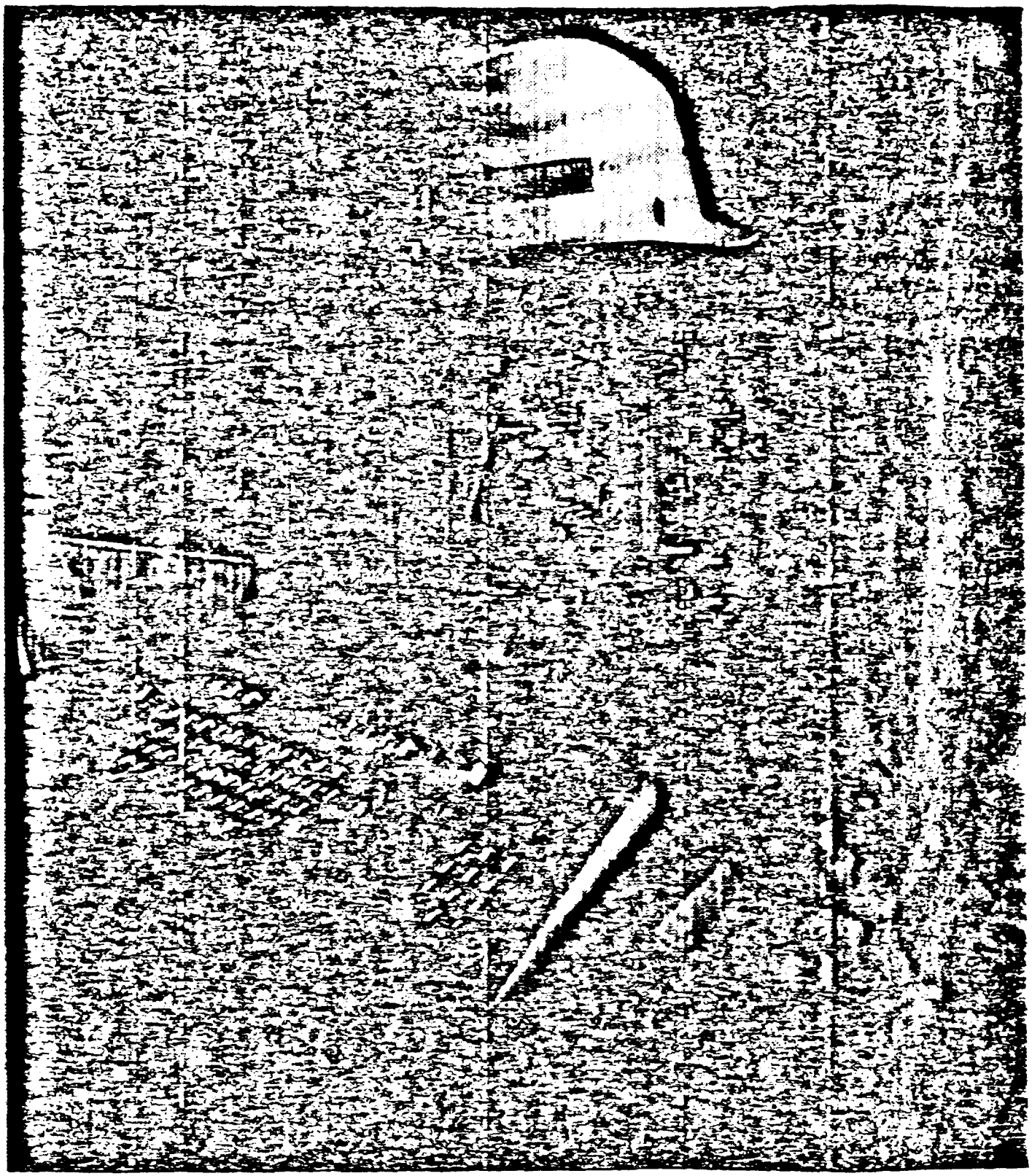
During the year, Crescent Resources, Inc., formerly Crescent Land & Timber Corp., continued to build a real estate development team that is competing successfully in the Carolinas market.

Among the developments started in 1989 are a 600-acre residential community called The Peninsula on Lake Norman, north of Charlotte; One Coliseum Centre, the first phase of a 175-acre mixed-use office and commercial project near Charlotte's new Coliseum; and 200 Meeting Street, a 150,000-square-foot office building in Charleston, S.C., to be anchored by NCNB National Bank of South Carolina.

In addition to its commercial development activity, Crescent owns and manages 270,000 acres of property and supplies timber and wood to the furniture, construction, and paper industries. In 1989, the company harvested 30.3 million board feet of timber and 41,730 cords of pulpwood.

In The Need For New Capacity

to build the Shuler line. Only a small portion of the acreage was needed for the line. To protect the unused portion of the tract, the Company began working with the Nature Conservancy and the U.S. Forest Service. In November, Duke Power sold this unused land to the Nature Conservancy, which then deeded the property to the Forest Service. ▼



Duke/Fluor Daniel, created in 1989, offers a one-stop source of design, construction and operation services for new and existing coal-fired generating plants

Hurricane Hugo Blows Into Duke Power Territory Leaving Everyone Breathless

Hurricane Hugo originated in the Caribbean, swept through Puerto Rico and the Virgin Islands and hit the U.S. mainland on September 21 at Charleston, S.C. A storm surge with 135-mile-an-hour winds knocked bridges off pilings, stranded boats in the middle of highways, and virtually wiped small coastal towns off the map.

By 3 a.m., residents in the Charlotte area, 200 miles inland, were waking to the sound of gusting winds and cracking trees. Over the next three hours the area was buffeted by rain and 85-mile-an-hour winds. Thousands of trees on which the city has prided itself, many more than 70 years old, suddenly became a liability, uprooting and crashing into homes, falling across power lines and snapping utility poles.

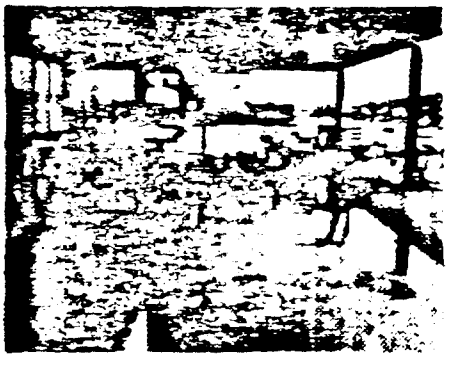
It was an experience that millions of Carolinians shared.

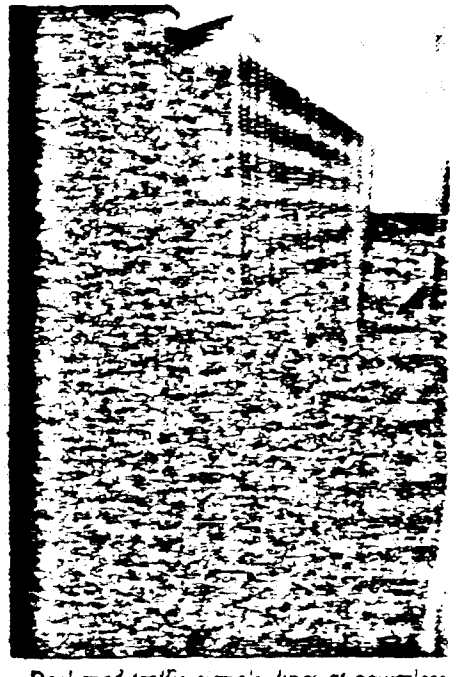
Hurricane Hugo was a nightmare for Duke Power and its customers. Even though the Company had prepared for the storm, the breadth and extensiveness of the damage was unprecedented. Until Hugo the worst storm for Duke Power had occurred in May 1989, when a series of tornadoes swept through portions of the Duke Power service area. These left about 250,000 Duke customers without power for up to several days, with the heaviest damage occurring in Winston-Salem, N.C.

Repairing damage from the May tornadoes proved to be a warm-up for Hugo. In its wake, nearly 700,000 customers system-wide lost power. Damage was reported in all eight of the Company's divisions. In the corporate headquarters city of Charlotte, the hardest-hit area, 98 percent of all customers (232,000 out of 237,000) were powerless, and for some, repairs would take over two weeks.

As is typical in most disasters, adversity brought out the best in people. Duke Power crews experienced the generosity and gratitude of Duke Power customers, who brought them food, coffee and other refreshments. For many line technicians, Hugo would mean weeks away from home. Repairs to their own homes would wait until the lights were back on. The same would be true for thousands of Duke employees who supported them.

Ultimately, 9,000 people would be a part of the recovery effort. Incredibly, they would virtually rebuild in days a distribution system that had taken years to build. The commitment of Duke Power to its customers, our employees' good humor and the dedication with which they attacked the repair effort, and the loyalty and gratitude of our customers, were never more clearly in view than during this time. This is the story of how that job was accomplished.





Darkened traffic signals, lines at powerless grocery stores, uprooted streets littered with glass and twisted, broken power lines were Hurricane Hugo's calling cards.

Line Crews Lead The Fight Against Hugo

In the days following Hurricane Hugo, they were the most popular people in town. Heads turned when they entered a restaurant. They saw anxious residents run to the curb as their trucks rolled into storm-ravaged neighborhoods. A routine repair job would be interrupted more than once by someone bringing a sandwich, a drink or some other snack.

No doubt about it, Hugo gave thousands of customers a new sense of appreciation for Duke Power line technicians.

An army of line technicians poured into the Duke service area in the wake of Hugo, traveling from up and down the Eastern Seaboard and from the Midwest. At the height of the repair effort, 9,000 workers were scattered throughout the service area. Of these, 6,500 were Duke line technicians or local electrical contractors whose crews frequently work on the Duke system.

The unprecedented size of the assembled work crews was prompted by the unprecedented damage that Hugo inflicted on the Duke service area. Ironically, the day before Hugo struck, Company officials were making plans to send Duke crews to help other utilities.

"Through Thursday (September 21), the forecast was that Hugo would pass to the east of us," said Roger Anderson, manager of the Distribution Engineering Division, who was responsible for setting up Duke's Storm Center. "We geared up thinking we'd send our troops elsewhere."

Anderson spent most of the evening on September 21 at home, tracking the path of the storm by television reports and through a home computer link with Duke's mainframe system. When he left for the office at 4 a.m. on September 22, he'd dropped the original plan.

"We knew we'd have to have all of our system crews to deal with the damage from Hugo. And as we received more damage reports, we began contacting other utilities and contractors. We were telling them we needed to know how many crews they could provide and that we could use every crew they could send."

And so the crews began arriving. They would be the front-line fighters in the repair effort, but the damage inflicted by Hugo was different. Even those who had worked in coastal areas after hurricanes had not seen such damage.

Candler Ginn, a design engineer with Georgia Power in Jonesboro, is a veteran of numerous repair campaigns, many on the Gulf Coast following hurricanes.

"I've never been that far inland (in Charlotte) and seen that much damage," Ginn said.

Working 16-hour shifts the first week, crews worked their way through the damaged portions of the Duke system. Most eventually found their way to Charlotte, where initially 98 percent of Duke customers were without power.

The problem for all the crews working in the Charlotte area was the city's pride—its trees. High winds toppled an estimated 80,000 trees, which pulled power lines down and snapped utility poles as they fell. Often it was impossible to judge where a line had been strung or where it was supposed to go. Just getting to the point on a map where a line was supposed to be could take hours. A fallen line might be dead or hot; it was impossible to tell at a glance.

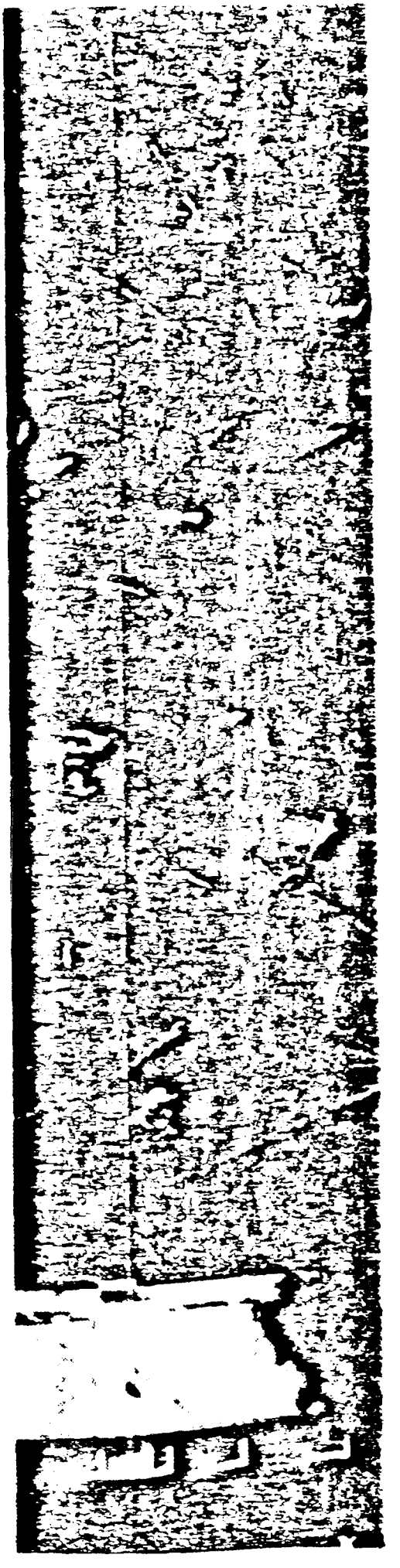
Duke customers were quick and effusive in their appreciation of the repair effort. As crews worked in neighborhoods, customers offered them meals and drinks. Members of a Charlotte church washed, dried and ironed one crew's clothes. Residents in the North Carolina towns of Belmont and Cramerton sponsored dinners at local restaurants in honor of the crews who restored their power, as did members of rural churches in the service area.

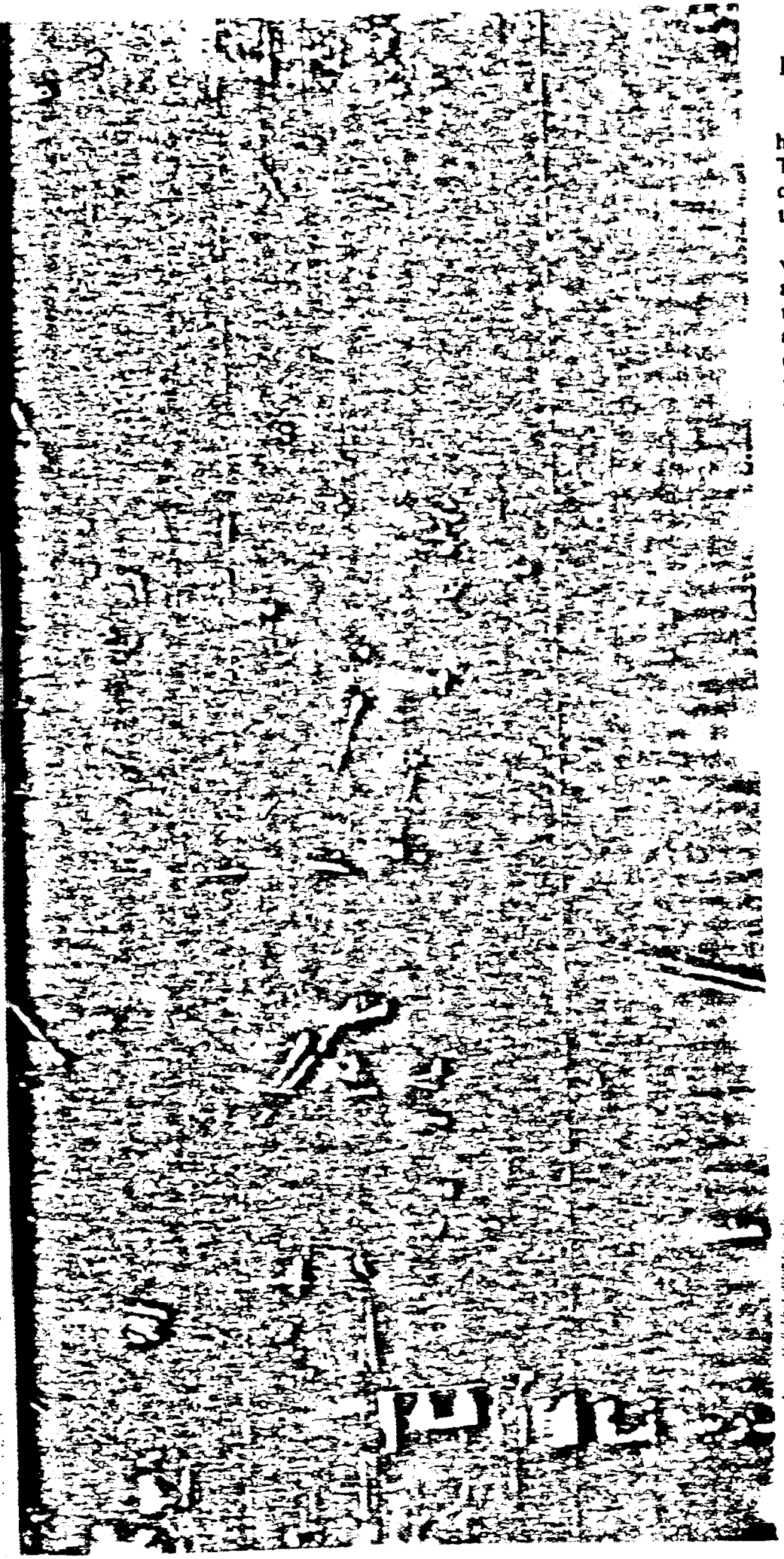
Generally customers were patient, though that attitude thinned for some as the days dragged on. When power was restored to larger areas, isolated outages remained, tempers sometimes flared as some customers sat in the dark while their neighbors had electricity.

The weather after Hugo was capricious. Immediately after the storm passed, the weather cleared and warmed. The following week, the weather turned cold and rainy, hampering repair efforts. Shifts were reduced, but crews still worked 12 to 14 hours a day.

More torrential rains hit the Piedmont a week after Hugo, dumping nearly seven inches of water on the region. The rain slowed repairs and flooded areas in the southern portion of Duke's service area, even though the Company had lowered lake levels earlier in anticipation of Hugo.

Restoring power to all of Duke Power's customers took just over two weeks. In that time crews rebuilt much of the Company's distribution network, a job that could not have been accomplished without the dedication and sacrifice of each Duke employee and contractor who participated in the repair effort, and the support from our customers.





Keeping the Supply Pipeline Full Was A 24-Hour Job

It's a good thing for Ned Chavers that his wife Barbara works at Duke Power's Toddville Stores Facility. Otherwise, chances are he'd have seen little of her in the weeks following Hurricane Hugo.

That's because Chavers, supervisor, inventory control in the Corporate Materials Management Department, helped direct the Company's two-week, 24-hour-a-day supply effort to ensure that line crews restoring power had the materials they needed to get the job done. During that time, Chavers, who usually works in uptown Charlotte, never saw his office. He was too busy working out of Duke's sprawling Toddville Stores Facility, where he and 140 co-workers were taking supply orders from the field, receiving materials from suppliers and shipping it back to line crews and repair workers almost as soon as it came in.

"We really never ran out of materials, but it was touch-and-go on some items," Chavers said. "For instance, we had to allocate some supplies as we got low to make sure we had enough to go around until we were able to restock. But we were always able to meet an order to some degree."

Sitting behind a desk in his office a few weeks after Hugo, Chavers spoke matter-of-factly, his words understating the challenges the Materials Management and Purchasing departments faced in the wake of Hurricane Hugo.

Chavers immediately knew that Hugo was no routine storm and that getting in to take supply orders from the field was the top priority. Even so, "We didn't really know in the beginning how bad it was," Chavers said. He was to find out.

Chavers and his wife left for Toddville the morning the storm struck the Charlotte area. Normally a 15-mile drive, the trip lengthened to 68 miles because of downed trees blocking the roads.

When Chavers arrived, he found that like just about everywhere else in the Charlotte area, Toddville had no power. There were no lights, no computer access, and only one telephone line. Before full phone service was restored that afternoon, personnel made calls over the one phone line to determine supply needs.

Hugo's winds destroyed thousands of acres of timberlands and woodlands, leaving behind scenes such as this.

Once an order was taken, workers pulled stock using flashlights. Office staffers worked by spotlight, keeping inventory records by hand instead of entering them on computer as they do normally.

They labored under those conditions for two days, until power was restored. Then, for the next two weeks, Toddville operated 24 hours a day. As soon as shipments from vendors were received, they would be reloaded onto Duke trucks for delivery to the field. Field employees constantly advised Toddville about road conditions so that a delivery truck would be able to get through.

By the end of the clean-up effort, Duke employees had received 667 shipments of materials, weighing almost 2,600 tons. They had shipped out 495 deliveries of materials weighing just under 7,700 tons.

The orders for all that material were placed by Duke's purchasing agents whose job was no less daunting than that of Materials Management. Like Chavers, Ed Morton, customer purchasing manager, works in uptown Charlotte.

"Our challenge was to figure out how to communicate with our vendors," Morton said.

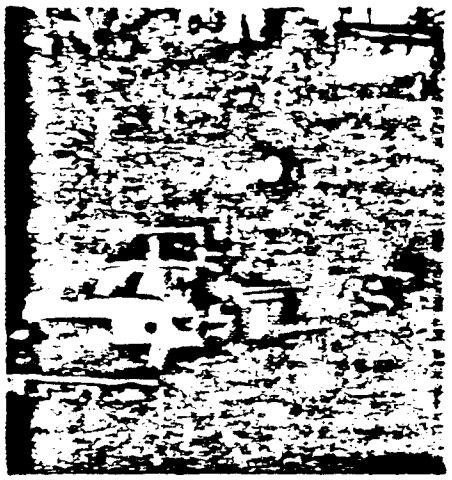
The storm disrupted many vendors and kept purchasing agents from reaching them until late on Friday, just the time when most were wrapping things up for the weekend.

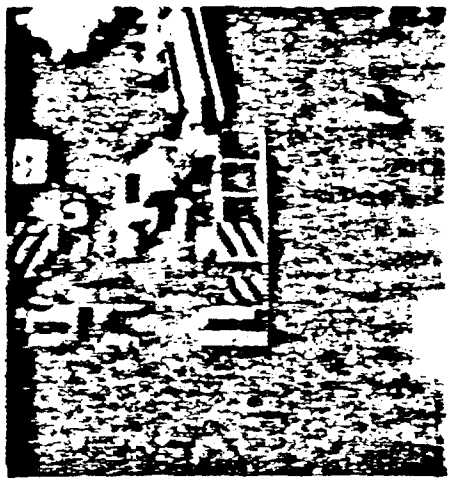
This was one weekend Duke Power could not rest.

"We didn't really get our feet on the ground until about 5 p.m. on Friday, so we were spending the weekend chasing people down at home, at restaurants, at church, anywhere we could find them," Morton said.

As soon as Morton and the other purchasing agents received requests for materials, they would immediately begin contacting vendors. They started first with the Company's regular suppliers and when their resources had been exhausted, buyers began "scouring the country," Morton said.

Many times a buyer would locate an item and order the supplier's entire stock to ensure that Duke crews had enough material to complete repairs. An especially valuable item that was already in short supply was an automatic splice that enables a line technician to join broken power lines in a matter of seconds. Morton estimated that Duke bought 170,000 to 200,000 splices in the two weeks following Hugo.





"Any time you have a storm, your supply depots are going to get hit," Morton said. "But Hugo was different. The damage it created was so massive that we literally started running out of everything we normally stock, and that just never happens. We never totally exhausted our supplies, but we came close on some items."

It took Duke Power more than two months to replenish its inventories after Hugo. Should disaster strike again, however, the inventory and purchasing managers at Duke Power will benefit from the experience of Hugo. The Company's primary supply facilities now have backup power systems, and Duke's buyers have assembled a directory of phone numbers where sales representatives can be reached in an emergency.

All of this information is part of a formal response plan, prepared, ready and waiting for the next storm.

* * *

Customer Contact Never Wavers In Days Following Storm

One call every seven seconds. Nine calls a minute. Twenty-four hours a day. For over two weeks.

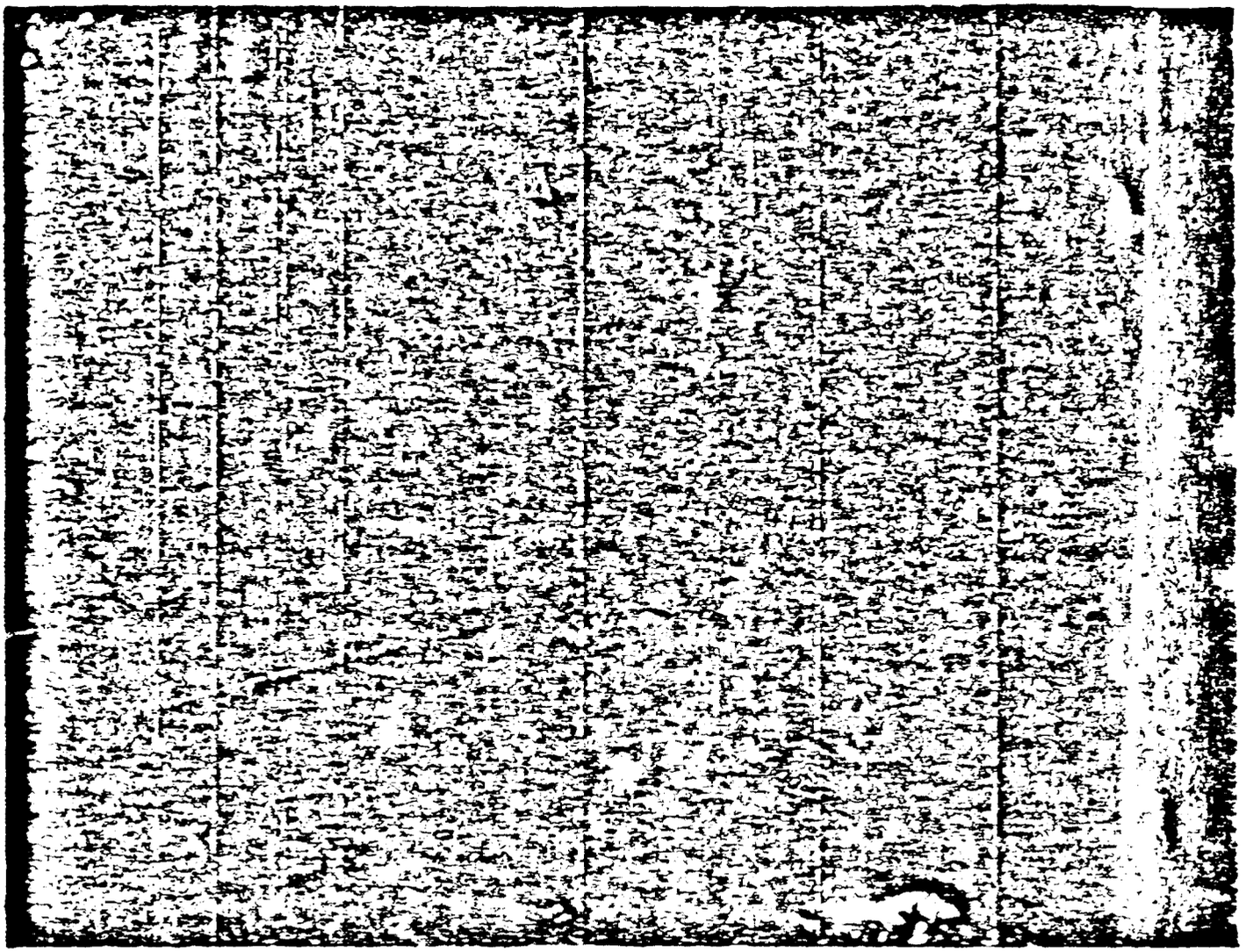
That's how many calls on average Duke Power received from Charlotte-area customers who lost power in the wake of Hurricane Hugo. In fact, in the first few days following the storm, outage reports weren't all that necessary — so many were affected that it was rarer to find a customer who had service than one who didn't.

Nevertheless, Duke Power was prepared to handle the deluge.

"It was decided from the beginning that we wanted to have enough capability to allow callers to speak with a person rather than an answering machine," said Mike Carpenter of Duke's Communication Systems Division. "The decision was made even though we could have handled a much larger volume of calls in a shorter period with an automated voice processing system."

Normally, Duke has 24 emergency lines available 24 hours a day to receive outage reports. Another 77 lines are available during regular business hours. After Hugo, all of these lines were combined into a 24-hour-a-day phone bank with 101 incoming lines.

Besides the staff of regular operators, dozens of volunteers from throughout the Company were recruited to take calls. Ul-



Duke Power crews, contractors and workers from other utilities worked 16 hours a day after the storm to repair fallen lines.

timately, around 70 operators were on duty at any one time. Volunteers got high marks from most callers for their professionalism and caring attitude.

At first, operators could do little to give callers an idea of when power would be restored in their neighborhood. As field reports began to identify specific circuits under repair, however, operators were able to give customers better information.

Often, an operator was simply someone who would listen, which was a hard job in itself. The most difficult calls were from the elderly, shut-ins, or those with medical problems who depended on electric power and felt lost and cut off without it. Volunteer Randy Brooks, a design engineer in the Oconee Division, remembered one call from a woman who said she lived alone and feared the night. "I'm so afraid when the sun goes down."

Of course there were many happy stories. Carol Case of Charlotte explained how her mother helped turn a frustrating call into a happy ending. After taking a call from a woman who complained she couldn't face another day without hot coffee, Case's initial frustration turned to concern as the woman explained that she was elderly, living in a six-room apartment house with other elderly residents. One had fallen down the stairs in her wheelchair in the dark and another had suffered a broken nose.

Case, feeling low, then called her mother and described the call. Her mother asked for the woman's name and address. A short time later, Case got a return call from her mother, who had brewed coffee and taken it to the elderly Duke Power customer.

"While Mother was explaining how she came to be there, the electricity was restored. In the excitement, the people in the apartment house did not understand Mother's explanation of how she came to be there. They hailed Duke Power as the greatest, most compassionate company ever. Who would have thought, they asked, that a company the size of Duke Power would actually send a representative with hot coffee to check on them?"

* * *

Storms of May a Dress Rehearsal for Hugo

Duke Power workers in the Company's Northern, Southern, and Western divisions viewed Hurricane Hugo's damage on September 22 with a strong sense of deja vu. After all, only four months earlier a series of tornadoes had ripped through these portions of Duke's service area, resulting in what, to that time, was the worst storm damage in Company history.

A total of 250,000 people in an area stretching from Greenville, S.C., to Greensboro, N.C., were without power for up to seven days because of the May storms. In Winston-Salem, N.C., which experienced some of the worst damage, the storm's aftermath looked to Winston-Salem Division Vice President Paul Briggs strikingly similar to the damage from Hugo.

"We had a massive wind storm in Winston-Salem and thousands of trees were on the ground. As the trees fell, our electrical distribution system was severely damaged and in some cases it was just blown away."

As with Hugo, one of the first problems the morning of May 6, 1989, the day of the tornadoes, was simply getting around in order to assess the damage. An on-call lineman in Winston-Salem had to hike to his office because fallen trees blocked his truck in his own driveway. Hundreds of oak trees were toppled by the high winds that buffeted the city, and one of Duke's first requests of city officials was for help in cutting away the fallen trees that clogged major thoroughfares.

A storm that disrupts 10,000 customers on the Duke system is considered very serious. The May storms were 25 times as bad. The operations managers knew immediately that repairing the storm damage would not be a short-term project. One thousand utility poles were down in the Winston-Salem area alone. The division's 350 line technicians were augmented by about 1,500 people from elsewhere in the Duke system, other utilities and contract crews. Thirty truckloads of supplies were shipped to Winston-Salem, including 18 loads of utility poles. With crews working 16-hour shifts, the last customer in Winston-Salem was returned to service after seven days.

Ironically in light of Hugo, which left some Duke customers without power for more than two weeks, the week required to restore service to Winston-Salem customers was, to that time, unprecedented, Briggs said.

"I had never imagined power being out after a storm as long as that," he said.

In retrospect, Duke Power learned lessons from the spring storms that proved helpful following Hurricane Hugo. An early problem following the tornadoes, for example, was finding places to feed the army of repair workers who trooped to Winston-Salem. Restaurants were unable to open without power. In evaluating the recovery from Hugo, the Company even explored the possibility of creating a standby field kitchen to feed repair crews during emergency situations.

Another lesson learned was the value of creating satellite command posts, putting managers directing repair and clean-up efforts in the field closer to repair crews. This shortened the communications chain and speeded the repair process.

Hugo's might was seen in heavily damaged homes and demolished automobiles but the storm also fostered cooperation among neighbors.

Duke expanded on this idea in Charlotte after Hugo, creating a field supply depot in a church parking lot near a section of town with particularly heavy storm damage. Field supervisors used a helicopter to direct work crews from the air.

Still, even with the knowledge gained from the May storms, Hurricane Hugo's strength was greater than anyone imagined it could be after traveling more than 200 miles inland from coastal South Carolina.

Future storms that affect the Duke Power service area may never approach the ferocity of a Hugo or of the thunderstorms and tornadoes that struck in May. But if they do, Duke Power will be even better prepared to deal with them.

▼ ▼ ▼

Letters From Customers Help Make the Work Go Easier

Hurricane Hugo gave everyone who experienced its wrath something to talk about for years to come. For days afterward, conversations centered on the storm, whether your power had been restored and how much damage Hugo had inflicted on you and your neighbors.

Those who experienced Hugo became a member of one large family of which no one who missed the storm could really be a part. Trying to tell someone who wasn't there how it felt to sit in the dark at 4 a.m., hearing the wind and the sound of splitting wood and wondering if a tree would soon be crashing onto the roof could never match the real-life event.

By far the most common experience was the lack of electricity. As the days dragged on, many people realized just how integral electricity is to their lives. Most customers showed a remarkable ability to cope as daily life took a giant step backwards, with candles and kerosene lanterns replacing electric lights. Charcoal grills substituted for electric ranges. Without power, televisions were silent, and families rediscovered radio and the art of conversation with each other and neighbors.

It wasn't all idyllic, of course. For many, particularly the elderly and the sick, being powerless represented a hardship that sometimes forced them to seek shelter with relatives or at hotels.

The Company's efforts to restore power did not go unnoticed. Many customers were effusive in their praise of Duke Power and its line crews and took the time

to write to let the Company know their feelings.

"Duke Power is still the best thing that ever happened to our area. No one else has ever been its equal. Magnificent job!"

* * *

"I'm writing to say I think all Duke Power employees are doing a great job and I appreciate all the sacrifices they've had to make in order to get us (Charlotte and surrounding areas) back 'on.' I also appreciate the cheerfulness of all the operators/customer service folks I've spoken with this week. It helps to brighten the day. Keep up the good work and THANKS!"

* * *

"Your crews should be commended for their efforts. Under very difficult circumstances, they worked steadily, efficiently, and successfully. Despite obvious long hours they maintained outstanding good humor, both toward the public and among themselves. Everyone I observed during that long period of time treated his fellow workers, regardless of their function, with dignity and consideration, when it would have been very understandable to have been irritable or short-tempered."

* * *

Children got into the action as well and provided some of the lighter moments in the days after Hugo:

"Thank you for fixing the power in Charlotte, even though I don't have electricity yet. But I can't blame you. I should blame Hugo."

One little girl found that no power meant less time for television:

"My mom and dad made me read a book. But I thank you for fixing the electricity! But now we have to go to school and we do not get to watch as much T.V. as we want to. But I thank you much for fixing the electricity!"

* * *

Hugo's Rewards: A Spirit of Community, Readiness For The Future

After it was all over, the most surprising thing was how well repair efforts had gone.

After all, restoring a distribution system in just over two weeks is not something any utility can really plan for. Before Hugo and the series of tornadoes that struck the Piedmont in May, the severest storms that affected Duke Power were ice storms. In such storms, an outage that affects 10,000 customers is a major emergency.

So when nearly 700,000 customers were affected by Hugo, the job facing Duke Power was without precedent.

Hugo reinforced the idea that in a major storm, early damage assessment is critical. Although Duke engineers surveyed the damage by air shortly after the storm passed through, they didn't have full knowledge of the extent of the damage until the survey was completed several days after the storm.

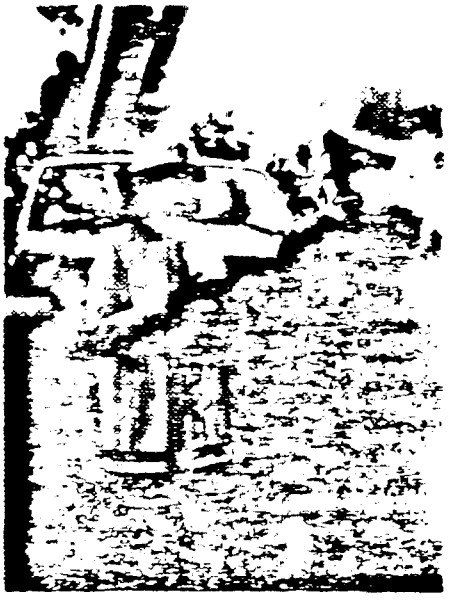
Effective communications, both internally and with the public and media, is another key factor. Duke has an extensive radio network for internal communications, but the volume of the traffic on the Company's frequencies was so high it overloaded the system. The Company countered the problem by setting up a temporary cellular telephone network.

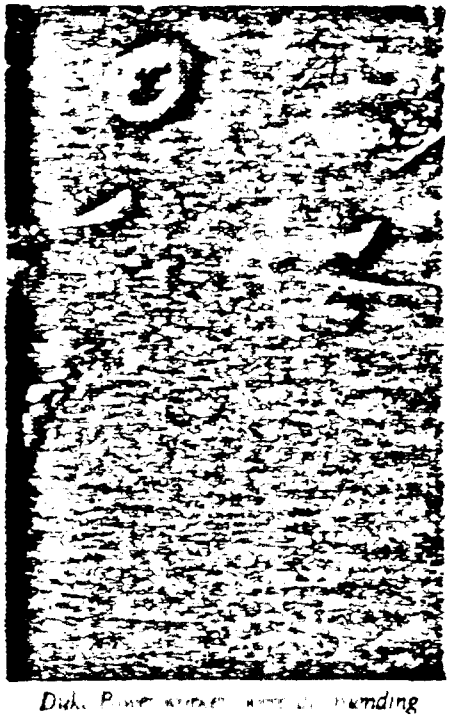
Maintaining communications with the public was a little easier. A hundred phone lines were available by the Monday following the storm to handle the large volume of calls received. The lines were staffed by volunteers from throughout the Company, and customers rarely had to wait to get through to an operator.

With damage occurring over a large area, satellite operations and supply centers proved to be valuable. Satellite operation centers kept those directing the repair efforts closer to the crews making the actual repairs, while the supply centers kept repair materials close at hand.

The most important element was the spirit of teamwork that developed among all who helped restore the Duke system. Many employees volunteered their personal time in addition to their regular duties. Many had damage to their own homes but gave a higher priority to helping restore electric service to Duke customers.

The widespread gratitude and appreciation expressed by customers were the result of those efforts. Never had Duke Power's corporate creed of Citizenship and Service been demonstrated so appropriately and so completely. In the future, other storms will certainly require more sacrifice and selfless service. But the response of Duke Power and its employees to Hurricane Hugo will stand as a model for those who serve in the years ahead. •





Duke Power [illegible] mending Hugo's damage. [illegible] everyone's lights [illegible] Halloween.

DUKE POWER COMPANY

Consolidated Statements Of Income

Dollars in Thousands — Year ended December 31,	1989	1988	1987
Electric revenues (Notes 1 and 2)	$3,639,339	$3,626,985	$3,705,784
Electric expenses			
Operation			
Fuel used in electric generation (Note 1)	660,212	626,191	624,814
Net interchange and purchased power (Note 3)	514,189	587,145	581,175
Wages, benefits and materials	508,743	529,129	485,192
Maintenance of plant facilities	348,944	383,307	375,085
Depreciation and amortization (Notes 1 and 10)	410,938	417,503	411,182
General taxes	184,134	182,000	173,897
Income taxes (Notes 1 and 4)	307,579	272,159	396,482
Total electric expenses	2,934,739	2,997,434	3,047,827
Electric operating income	704,600	629,551	657,957
Other income (Notes 1, 4 and 13)			
Allowance for equity funds used during construction	61,347	52,616	36,742
Other, net	28,930	16,978	18,002
Provision for abandonment loss (Note 12)	—	(81,999)	—
Income taxes — abandonment loss (Note 4)	—	34,967	—
Income taxes — other, net	(9,053)	3,547	(4,397)
Income taxes — credit	20,602	20,102	22,555
Total other income	101,826	46,211	72,902
Income before interest deductions	806,426	675,762	730,859
Interest deductions			
Interest on long-term debt	237,187	235,061	237,367
Other interest	16,505	7,979	3,853
Allowance for borrowed funds used during construction (credit) (Note 1)	(18,877)	(15,409)	(10,559)
Total interest deductions	234,815	227,631	230,661
Income before cumulative effect of change in accounting method	571,611	448,131	500,198
Cumulative effect of a change in method of accounting for unbilled revenues, net of income taxes (Note 1)	—	102,255	—
Net income	571,611	550,386	500,198
Dividends on preferred and preference stocks	52,477	53,329	54,264
Earnings for common stock	$ 519,134	$ 497,057	$ 445,934
Common stock data			
Average shares outstanding (thousands)	101,277	101,266	101,250
Earnings per share before cumulative effect of change in accounting method	$5.13	$3.90	$4.40
Cumulative effect of a change in method of accounting for unbilled revenues	—	1.01	—
Total earnings per share	$5.13	$4.91	$4.40
Dividends per share	$3.04	$2.88	$2.74

Consolidated Statements Of Cash Flows

Dollars in Thousands — Year ended December 31.	1989	1988	1987
Cash flows from operating activities			
Net income	$ 571,611	$ 550,386	$ 500,198
Adjustments to reconcile net income to net cash provided by operating activities:			
Non-cash items			
Depreciation and amortization (Notes 1 and 10)	605,105	632,866	616,956
Deferred income taxes and investment tax credit, net of amortization (Note 4)	61,063	(16,699)	82,623
Allowance for equity funds used during construction	(61,347)	(52,616)	(36,742)
Purchased capacity levelization (Note 3)	(95,216)	(95,738)	(134,452)
Provision for abandonment loss (Note 12)	—	81,999	—
Cumulative effect of a change in method of accounting for unbilled revenues, net of income taxes (Note 1)	—	(102,255)	—
Other, net	21,154	62,970	46,367
(Increase) Decrease in			
Accounts receivable	(63,285)	(5,464)	(6,360)
Materials and supplies	(13,960)	(4,203)	(15,837)
Prepayments	915	1,630	1,323
Increase (Decrease) in			
Accounts payable	29,249	41,935	42,396
Taxes accrued (Note 4)	49,961	(19,010)	(54,692)
Interest accrued and other liabilities (Note 9)	3,628	7,061	(43)
Total adjustments	537,267	532,476	541,539
Net cash provided by operating activities	1,108,878	1,082,862	1,041,737
Cash flows from investing activities			
Construction expenditures	(819,799)	(754,076)	(611,374)
Investment in nuclear fuel	(179,093)	(142,575)	(129,510)
Purchase of Nantahala Power and Light	—	(29,576)	—
Proceeds from sale of assets	—	—	23,496
Net change in investment securities (Note 1)	26,515	198,586	55,656
Net cash used in investing activities	(972,377)	(727,641)	(661,732)
Cash flows from financing activities			
Proceeds from the issuance of			
First and refunding mortgage bonds	—	—	245,866
Pollution-control bonds	15,906	1,283	38,734
Nuclear fuel trusts	50,945	85,612	77,388
Preferred stock	—	—	49,563
Short-term notes payable (Note 5)	170,000	—	—
Other long-term debt	130,000	—	—
Payments for the redemption of			
First and refunding mortgage bonds	—	—	(285,752)
Pollution-control bonds	—	—	(25,000)
Nuclear fuel trusts	(136,945)	(85,612)	(76,388)
Preferred stock	(8,025)	(8,025)	(50,848)
Payments under capital lease obligation	(4,748)	(4,348)	(3,982)
Dividends paid	(360,352)	(344,964)	(331,691)
Net cash used in financing activities	(143,219)	(356,054)	(362,110)
Net increase (decrease) in cash	(6,718)	(833)	17,895
Cash at beginning of year	20,676	21,509	3,614
Cash at end of year	$ 13,958	$ 20,676	$ 21,509

See Notes to Consolidated Financial Statements

Consolidated Balance Sheets

Dollars in Thousands	December 31,	1989	1988
Assets			
Electric plant (at original cost — Notes 1, 3, 9 and 12)			
Electric plant in service		$9,738,983	$9,121,987
Less accumulated depreciation and amortization		3,374,412	3,104,088
Electric plant in service, net		6,364,571	6,017,899
Nuclear fuel		1,694,967	1,537,534
Less accumulated amortization		1,397,475	1,219,828
Nuclear fuel, net		297,492	317,706
Construction work in progress (including nuclear fuel in process: 1989 - $159,034; 1988 - $125,194)		1,255,232	1,038,091
Total electric plant, net		7,917,295	7,373,696
Other property and investments			
Other property — at cost (less accumulated depreciation: 1989 - $68,391; 1988 - $64,677)		144,513	106,843
Other investments, at cost or less		121,103	115,957
Total other property and investments		265,616	222,800
Current assets			
Cash (Note 5)		13,958	20,676
Short-term investments		58,050	89,711
Receivables (less allowance for losses: 1989 - $3,837; 1988 - $3,690) (Note 1)		519,839	456,554
Materials and supplies — at average cost			
Coal		84,036	83,405
Other		182,951	169,622
Prepayments		11,209	12,124
Total current assets		870,043	832,092
Deferred debits			
Purchased capacity costs (Note 3)		239,671	192,084
Canceled construction projects (Notes 10 and 12)		144,128	182,542
Debt expense (Note 1)		73,191	75,835
Other		32,454	11,556
Total deferred debits		489,444	462,017
Total assets		$9,542,398	$8,890,605
Capitalization and Liabilities			
Capitalization (See Consolidated Statements of Capitalization)		$7,154,274	$6,856,723
Current liabilities			
Accounts payable		306,232	264,988
Taxes accrued (Note 1)		76,613	26,652
Interest accrued		67,992	67,945
Other		60,915	57,334
Total		511,752	416,919
Notes payable (Note 5)		170,000	—
Current maturities of long-term debt and preferred stocks		13,210	51,343
Total current liabilities		694,962	468,262
Accumulated deferred income taxes (Notes 1 and 4)		1,206,730	1,117,383
Deferred credits and other liabilities			
Investment tax credit (Notes 1 and 4)		324,466	331,644
Other		161,966	116,593
Total deferred credits and other liabilities		486,432	448,237
Commitments and contingencies (Note 12)			
Total capitalization and liabilities		$9,542,398	$8,890,605

See Notes to Consolidated Financial Statements.

Consolidated Statements Of Capitalization And Retained Earnings

Dollars in Thousands	December 31,	1989	1988
Capitalization			
Common stock equity (Notes 6 and 7)			
Common stock, no par; 150,000,000 shares authorized; 101,281,445 shares outstanding for 1989 and 101,272,023 shares outstanding for 1988		$1,862,721	$1,862,495
Retained earnings		1,793,829	1,581,901
Total common stock equity		3,656,550	3,444,396
Preferred and preference stocks without sinking fund requirements (Note 7)		427,457	427,683
Preferred stocks with sinking fund requirements (Note 8)		247,825	255,850
Long-term debt (Note 9)			
First and refunding mortgage bonds		2,645,838	2,630,803
Capitalized leases		78,812	75,560
Other long-term debt		138,000	—
Nuclear fuel trusts		—	86,000
Unamortized debt discount and premium, net (Note 1)		(19,023)	(20,251)
Current maturities of long-term debt		(5,185)	(43,318)
Total long-term debt		2,822,442	2,728,794
Total capitalization		$7,154,274	$6,856,723

Dollars in Thousands	Year ended December 31,	1989	1988	1987
Retained Earnings				
Balance — Beginning of year		$1,581,901	$1,374,093	$1,210,229
Add — Net income		571,611	550,386	500,198
Total		2,153,512	1,924,479	1,710,427
Deduct				
Dividends				
Common stock		307,875	291,635	277,427
Preferred and preference stocks		52,477	53,329	54,264
Capital stock transactions, net		(669)	(2,386)	4,643
Total deductions		359,683	342,578	336,334
Balance — End of year		$1,793,829	$1,581,901	$1,374,093

See Notes to Consolidated Financial Statements.

Notes To Consolidated Financial Statements

Note 1. Summary of Significant Accounting Policies

A. Revenues

To provide a better matching of revenues and expenses, the Company changed its accounting policy of recognizing revenue to provide for the accrual of estimated unbilled revenues effective January 1, 1988. Prior to 1988, the Company recognized revenues concurrent with billings to customers. The cumulative effect of this accounting change, less income taxes of $63,803,000, amounted to $102,255,000 and was included in 1988 income. Other than the recording of the cumulative effect adjustment, the new accounting method had no material effect on net income for 1988. Had this new accounting method been in effect during 1987, net income would not have been materially different from that shown in the accompanying financial statements. Unbilled revenues of $195,867,000 and $166,767,000 are recorded as a component of "Receivables" on the Consolidated Balance Sheets as of December 31, 1989 and 1988, respectively.

B. Additions to Electric Plant

The Company capitalizes all construction-related direct labor and materials as well as indirect construction costs. Indirect costs include general engineering, taxes and the cost of money (allowance for funds used during construction). The cost of renewals and betterments of units of property is capitalized. The cost of repairs and replacements representing less than a unit of property is charged to electric expenses. The original cost of property retired, together with removal costs less salvage value, is charged to accumulated depreciation.

C. Allowance for Funds Used During Construction (AFUDC)

AFUDC represents the estimated debt and equity costs of capital funds that are necessary to finance the construction of new facilities. AFUDC, a non-cash, non-operating item, is recognized as a cost of "Construction work in progress" (CWIP), with offsetting credits to "Other income" and "Interest deductions." After construction is completed, the Company is permitted to recover these capital costs, including a fair return, through their inclusion in rate base and in the provision for depreciation.

AFUDC, which is compounded semiannually, was calculated on average embedded rates (net of applicable income taxes) of 9.35 percent for 1989, 9.34 percent for 1988 and 9.11 percent for 1987.

D. Depreciation and Amortization

Provisions for depreciation are recorded using the straight-line method. The year-end composite weighted-average depreciation rates were 3.58 percent for 1989, 3.61 percent for 1988 and 3.60 percent for 1987. All coal-fired generating units are depreciated at the rate of 3.57 percent. Nuclear units are depreciated at a rate of 4 percent, which includes an allowance for decommissioning costs.

The Nuclear Regulatory Commission (NRC) issued a rulemaking in 1988 which will require an external mechanism to fund the liability to decommission the components of a nuclear unit subject to radioactive contamination. The minimum funding level mandated by the NRC is approximately $100 million per unit in 1986 dollars to be funded by the end of the licensed life of the plant. The other joint owners of the Catawba Nuclear Station are liable for funding decommissioning activities related to their ownership interest in the station. The Company is required to submit a funding plan to the NRC by July 1990.

Amortization of nuclear fuel is included in "Fuel used in electric generation" in the Consolidated Statements of Income. The amortization is recorded using the unit-of-production method.

Under provisions of the Nuclear Waste Policy Act of 1982, the Company has entered into contracts with the Department of Energy (DOE) for the disposal of nuclear fuel. Payments made to the DOE for disposal costs are based on nuclear generation and are included in "Fuel used in electric generation" in the Consolidated Statements of Income.

E. Subsidiaries

The Company's consolidated financial statements reflect consolidation of all of its wholly owned subsidiaries, in accordance with a statement issued by the Financial Accounting Standards Board (FASB). All significant intercompany transactions have been eliminated in consolidation. Information for 1987 has been restated to conform to the new presentation. (See "Subsidiary Investments," page 43.)

Note 1. Summary of Significant Accounting Policies (Continued)

F. Income Taxes

The Company and its subsidiaries file a consolidated federal income tax return. Income taxes are allocated to each company based on its separate company taxable income or loss.

Income taxes are allocated to non-electric operations under "Other income" and to electric operating expense. The "Income taxes — credit" classified under "Other income" results from tax deductions of interest costs relating primarily to investments in CWIP, canceled construction projects and short- and intermediate-term investments.

Deferred income taxes have been provided for timing differences between book and tax income, principally resulting from accelerated tax depreciation, levelization of purchased power costs, canceled construction projects and unbilled revenues. Investment tax credits are deferred and amortized over the estimated useful lives of the related properties.

G. Unamortized Debt Premium, Discount and Expense

Expenses incurred in connection with the issuance of presently outstanding long-term debt, and premiums and discounts relating to such debt, are being amortized over the terms of the respective issues. Also, any expenses or call premiums associated with refinancing higher-cost debt obligations are being amortized over the lives of the new issues of long-term debt.

H. Fuel Cost Adjustment Procedures

Fuel costs are reviewed semiannually in the wholesale and South Carolina retail jurisdictions with provisions for changing such costs in base rates. In the North Carolina retail jurisdiction, a review of fuel costs in rates is required annually and during general rate case proceedings.

All jurisdictions allow the Company to adjust for past over- or under-recovery of fuel costs. Therefore, the Company reflects in revenues the difference between actual fuel costs incurred and fuel costs recovered through rates.

The North Carolina legislature ratified a bill in July 1987 assuring the legality of such adjustments in rates. The bill has a sunset provision which has been extended to July 1, 1991.

I. Consolidated Statements of Cash Flows

The FASB issued a statement requiring the implementation of the Consolidated Statements of Cash Flows in 1988. The Consolidated Statements of Cash Flows replaces the Statements of Changes in Financial Position provided in previous years. Information for 1987 has been restated to conform to the new presentation. For purposes of the Consolidated Statements of Cash Flows, the Company's investments in highly liquid debt instruments with a maturity of three months or less are included in cash flows from investing activities, and thus are not considered cash equivalents.

Note 2. Rate Matters

The North Carolina Utilities Commission (NCUC) and The Public Service Commission of South Carolina must approve rates for retail sales within their respective states. The Federal Energy Regulatory Commission must approve the Company's rates for sales to wholesale customers. Sales to the other joint owners of the Catawba Nuclear Station, which represent a substantial majority of the Company's wholesale revenues, are now set through contractual agreements (see Note 3).

Changes in retail rates implemented by the Company since January 1, 1986, include rate increases of 6.73 percent, effective October 1986, and 9.55 percent, effective November 1986, in the North Carolina and South Carolina retail jurisdictions, respectively. These increases provided for recovery of the Company's investment in Catawba Unit 2 and payments related to the purchased power contracts with the plant's other joint owners. As a result of an appeal by certain parties of the Company's 1986 rate order of the NCUC, the Company's authorized return on common equity was reduced in 1989 from 13.40 percent to 13.20 percent (see Note 12).

The Company reduced retail rates by 2.3 percent on January 1, 1987, and by an additional 3 percent on January 1, 1988. These reductions recognize the lower corporate income tax rate included in the Tax Reform Act of 1986.